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December 18, 2000

The Honorable Vernon A. Williams
Secretary
The Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures

Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are the original and twenty-five copies of the Reply Comments of The Burlington Northern and Santa Fe Railway Company. Also enclosed is a 3.5 inch disk, containing the text of the Reply Comments in WordPerfect 9 format.

I would appreciate it if you would date-stamp the enclosed extra copy of the Reply Comments and return it to the messenger for our files.

Sincerely,

Erika Z. Jones

Erika Z. Jones

Enclosures
cc: All Parties of Record

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BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REPLY COMMENTS OF THE BURLINGTON NORTHERN
AND SANTA FE RAILWAY COMPANY

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December 18, 2000

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EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REPLY COMMENTS OF THE BURLINGTON NORTHERN
AND SANTA FE RAILWAY COMPANY

The Burlington Northern and Santa Fe Railway Company ("BNSF") hereby files its reply comments on the Notice of Proposed Rulemaking ("NPR") issued by the Surface Transportation Board ("STB") on October 3, 2000.

I. INTRODUCTION

After reviewing the comments filed by the parties on November 17, 2000, BNSF continues to believe that the interests of stakeholders in the rail industry — shippers, regional and short line railroads, ports, Class I railroads, investors and others — would be best served if the Board's final revised merger rules reflect several key principles that are the foundation of the specific regulatory proposals contained in BNSF's initial comments.[1]

- First, the Board should act on a Class I merger application within 12 months of the pre-filing notice, using the proposed schedule included as Attachment 1 to BNSF's November 17 comments. Prompt Board action is necessary to serve the interests of shippers, railroads and other interested parties. It also is required to assure continued access to capital markets for the industry. If new rules better define the issues that merger applications must address, the Board should be able to complete its review of a merger

[1] BNSF's proposals are summarized on pages 10–11.

within 12 months, a schedule which is more consistent with the review period in other industries. At the very least, the Board should reject the proposals that would unnecessarily delay either Board review or the implementation of an approved merger.

- Second, the final regulations should not impair the ability of railroads to attract the capital required to make the investments necessary to expand rail capacity and meet shippers' service expectations. However, the ability of railroads to attract or, indeed, retain capital would be adversely affected by the many proposals that would increase regulatory uncertainty, eliminate finality in merger review, and impose onerous new regulatory requirements on railroads that jeopardize their ability to earn a return on investments made in the rail freight transportation industry.

- Third, and closely related to the prior point, the Board should reject the many calls for the extensive reregulation of the rail industry, whether raised in this review of the Board's merger review policy or on a more general basis. While there was a broad consensus that any identified reductions in competition that would be produced by a proposed merger must be directly remedied, many commenters nonetheless supported the NPR proposal that any future mergers be conditioned on the mandated adoption of non-remedial competitive enhancements.[2] Other commenters requested that the Board condition any future — and, indeed, re-condition past — mergers on general reregulation of the rail industry.

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2 There were disagreements on the "one lump" theory and the competitive effects of a merger on 3-to-2 shippers. As discussed below, these issues are best decided on the basis of a record compiled with respect to a specific merger and specific shippers.

However, fundamental changes to the existing regulatory structure, such as those inherent in the NPR and vigorously advocated by some commenters, would have far-reaching and detrimental consequences for the rail industry (and, as BNSF showed in its initial comments, would be contrary to the Board's statutory authority and therefore unlawful). Capital-intensive network industries, particularly the rail industry, depend upon differential pricing. Mandatory schemes for partial or complete "open access," however labeled or justified, would entail comprehensive economic and service reregulation of the industry and threaten service quality. Furthermore, as evidenced by calls to apply these remedies to past mergers or to the entire industry, these proposals are not directly related to the revision of merger rules undertaken by the Board. Therefore, the Board should maintain its policy of not imposing non-remedial competitive enhancements on Class I mergers. It also should reject broader calls for reregulation of the rail industry and adhere to its position that merger policy is not an appropriate vehicle for a reversal of the policies of the 4R and Staggers Acts. Any such reversal, in any case, could be enacted only by Congress, not the Board.

- Fourth, BNSF urges the Board to continue its tested practice of reviewing the merits of proposed mergers on the basis of case-specific records, accepting (or imposing) conditions that maintain effective competitive alternatives for directly affected shippers. The Board should not replace this case-by-case review with the three presumptions that are the foundation of the NPR.[3] The presumptions are unsupported by the NPR itself or

[3] The three presumptions of the NPR are: there will not be significant public benefits from future mergers; all future mergers will produce unremedied competitive harms; and all future mergers will produce transitional service problems.

by specific facts in the November 17 comments and, as shown in the comments of BNSF and the supporting verified statements, are inaccurate. If these presumptions are properly rejected, there would be no basis for the proposed requirement that merging carriers offer non-remedial, mandated "competitive enhancements." Furthermore, the Board should not, as some commenters suggested, ignore either intermodal competition or the evidence of strong intra-modal competition when reviewing the benefits of competitive enhancements which are part of the proposed transaction or voluntarily offered by merging carriers.

- Fifth, BNSF, joining almost all the commenters in this proceeding, supports the NPR's emphasis on detailed review of the plans of merger applicants for implementing their mergers and continuing review of service performance issues during the oversight period. BNSF and the entire rail industry are committed to avoiding any repetition of the temporary service problems that followed the UP/SP and Conrail/CSX/NS combinations. However, the Board should not adopt the proposals of those commenters who believe that the Board's merger regulations should specify the remedies and/or procedures, including mandatory arbitration at the election of the shipper, to be followed in the unlikely event there are significant merger-related service problems in the future. Shippers already may pursue remedies through the Board's Ex Parte No. 628 procedures, as well as through law suits and the provisions of many service contracts. Additional remedies and procedures should be developed in each merger proceeding, but any remedies should be limited to merger-related service problems. For example, in order to meet the service requirements of shippers, railroads must have the ability to expand and upgrade their infrastructure without penalty, even if normal operations may have to be limited during the construction period. The service provided by a merged railroad also can be affected by extreme weather, unexpected surges in demand for specific products, and business cycles in the overall economy. In any event, a merged carrier, with its greater resources, may have an increased ability to respond expeditiously to these non-merger-related problems than other carriers.

* * * * *

After the heated debates of this past year, it is time for the Board to restore perspective and balance to the future rail merger discussion. The current regulatory structure has served America well — the Board's existing merger policies have allowed efficiency-producing mergers to go forward, improved the financial health of the rail industry, produced increased intermodal service, expanded the availability of single-line and enhanced services to shippers, and, as demonstrated by the general decline in real rail rates across all sectors, protected shippers against decreases in the level of effective competition.

In sharp contrast, if either the NPR's original proposals or the open-ended calls by many for reregulation of the rail industry are adopted, the results will be bad for railroads, shippers, investors and other segments of the national transportation infrastructure, as well as the U.S. economy and the economies of its trading partners. Mergers that would be in the public interest will not be proposed or approved, because the Board, unlike any other U.S. regulatory authority that reviews other industry mergers, effectively would require merger applicants to submit to mandated competitive enhancements and, therefore, extensive regulation, rather than remediation of specific merger-related harms. Railroads will be unable to attract the capital necessary to produce the service improvements shippers desire, because investors will not be willing to provide funds to an industry under the threat of reregulation, including, at least under some proposals, reregulation that might be triggered by the mergers of other railroads.

Based on these principles, the Board's revised merger regulations should contain the following elements:

1. The Board should complete its review of any merger application within one year of the pre-filing notice, and the Board should reject those proposals that would extend the review period, limit the ability of merger applicants promptly to file their application, or constrain the ability of the merged carrier fully to implement the merger.

2. The Board should not adopt the presumptions that future mergers will not produce public benefits, that mergers will produce unremedied competitive harms, and that mergers will cause transitional service problems. The Board should not require that merger applicants propose "competitive enhancements" that are not remedial in nature, and it should reject all proposals that call for significant reregulation of the rail industry, including open access, competitive access and rate proposals. The Board also should not adopt detailed regulatory prescriptions for all the issues raised in merger cases. Instead, these issues should be addressed based on the facts of any specific merger proposal, using the Board's tested case-by-case approach.

3. The final rules should require merging carriers to propose plans for maintaining effective competition for shippers. Such plans should include proposals to maintain existing major gateways as open on an operational and economic basis, and to

preserve (a) service options for 2-to-1 shippers, (b) build-in/build-out and transload opportunities of shippers, and (c) contract exception rights for shippers even when the merged carrier can provide single-line service to a shipper. The final rules should require merger applicants to address whether any shipper would lose effective competition as a result of the merger and, if so, propose conditions to maintain that effective competition.

4. The rules should require the full analysis and, as appropriate, remedy of competitive issues raised by a specific merger, but this factual analysis must be on a case-by-case basis.

5. The final rules should require merger applicants to provide detailed service assurance plans. The adequacy of the plans and any proposals to provide shippers with remedies in the event that service deteriorates for merger-related reasons should be part of the Board's public interest determination, but the Board should not dictate the nature of any remedies in its rules.

6. The rules should state expressly that post-merger oversight review will be limited to merger-related service problems and the efficacy of any remedial competitive conditions adopted as part of the merger.

II. DISCUSSION

A. Railroad Mergers Need to Be Handled Expeditiously

In its initial comments, BNSF presented a schedule that would result in final Board action on merger applications within one year of the pre-filing notice. BNSF's initial comments demonstrated that railroads, which must compete for capital in the open market, would be disadvantaged by the NPR's proposed schedule for reviewing merger applications. BNSF is pleased that some commenters recognized the importance of timely review by the Board.[4]

However, several commenters proposed procedures and substantive standards that could result in open-ended periods for reviewing merger applications and then implementing approved mergers. For example, BASF and Williams Energy Service suggested that the Board address mergers in three stages: corporate, business and operational. While these distinctions are not precisely clear, BNSF is concerned that the approval of the "corporate merger" could be deemed to satisfy the statutory or regulatory deadlines, thereby eliminating any real deadline for final Board action.

Other commenters suggested that the Board require evidence that various groups were formally consulted before any merger application is filed.[5] BNSF certainly will attempt to work with all interested parties in the event it pursues another merger. However, the

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4 *E.g.*, CSX Corporation and CSX Transportation at 57–60; Port of Corpus Christi Authority at 3; Port of Portland at 3; Port of Seattle at 3–4; Texas Mexican Railway Company at 4–5. The National Industrial Transportation League ("NIT League") noted in its comments that the Board would in all likelihood be able to process mergers more expeditiously if its rules were more specific. NIT League at 11, footnote 2.

5 *See, e.g.*, Oklahoma Department of Transportation at 12; Port of Corpus Christi at 2–3; New Jersey Transit Corporation at 10.

Board should reject any proposed requirements that would delay the timely filing of a merger application because of mandated consultations with other groups.

One commenter suggested that the Board should stop processing a pending application if the "downstream" analysis required by the proposed rules suggests that downstream merger proposals will result.[6] Another commenter requested that the Board impose a three-year moratorium after each Class I merger.[7] The first proposal would unreasonably delay, or even terminate, Board action on a pending merger. The second would place restrictions on the rail industry and its ability to service its customers that are unique and would prevent or defer subsequent mergers that would produce public benefits. Furthermore, any such moratorium would be contrary to the statutory provisions governing the Board's review process.

The goal of prompt regulatory action is to accelerate the delivery of the benefits to the public, shippers and investors that drive merger proposals. Therefore, the Board also should reject all proposals that would require Board approval before each step in the merger implementation process can be taken.[8] Regulatory micromanagement of this process would be a destructive idea, even if the Board had the resources to do it, and merging carriers must have the flexibility to adjust their plans to respond to changing circumstances. Because a merged carrier will be responsible for service failures pursuant

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6 The Procter & Gamble Company at 6.

7 Committee to Improve American Coal Transportation at 19.

8 *See*, *e.g.*, BASF at 12–13, 28–30; City of Mankato, MN at 4–5; City of Owatonna, MN at 5; U.S. Department of Transportation ("DOT") at 11–12; Williams Energy Services at 3–4.

to a service assurance plan, it also must have the ability to manage the details of the merger implementation.

Therefore, the Board should adopt BNSF's proposed schedule, which would result in final Board action within one year of the pre-filing notice of a merger. The Board should reject any proposals that would lengthen this schedule or require the Board to manage the details of the merger implementation process.

B. Many Proposals Would Result in Reduced Access to Capital Markets

The initial comments were unanimous on the need for the rail industry to improve the quality of rail transportation and to develop new services to meet the needs of shippers. These improvements are necessary for railroads to compete with other transportation modes and for shippers to compete in their own industries. Improved service cannot be produced by regulatory mandate or shipper demands.

Instead, offering improved service and expanded service options to rail customers will require railroads to invest in infrastructure, rolling stock, and improved information technology. However, as discussed in BNSF's November 17 filing, the investment needs of the railroads must compete for other uses of capital in the economy. If railroads cannot achieve returns on their investments that are competitive with returns in other industries, they will not be able to attract or retain capital. If railroads do not have access to capital, service will not improve and may, in fact, deteriorate. Indeed, prior to the Staggers Act, the rail industry and rail customers experienced first-hand the problems that are created when capital flees the industry.

Yet given the industry's need to expand capacity and offer new services, the NPR and the additional proposals of many commenters would send exactly the wrong signals to capital markets.

First, capital markets flee from uncertainty. However, all the comments are clear on one point — the proposed regulations do not provide interested parties with any clear indications of what future merger applicants must show or what conditions might be applied to future mergers.[9]

Second, to the extent there are such indications, they suggest that the price of any future merger may be mandated competitive enhancements that are intended to reduce the merged railroad's revenues. Many commenters put forth proposals that are clearly intended to eliminate "differential pricing" in the industry and to drive down future rail rates, including expansive gateway regulation, post-merger rate caps, elimination of paper and steel barriers with short line and regional carriers, competitive access, reciprocal switching and trackage rights, and revised bottleneck rules.[10] These proposals would depress the earnings capacity of an industry that still has not achieved revenue adequacy (although its financial health has improved), a result that, in turn, would lead to reduced investment or, indeed, disinvestment in the rail industry. This is not a theoretical prospect; it is exactly what happened before Congress wisely decided, in the 4R and Staggers Acts, to change

9 *See, e.g.*, Association of American Railroads at 26–27; The Dow Chemical Company at 3–4; Enron Corporation at 1; Kansas City Southern Railway Company at 5; NIT League at 3; PPG Industries, Inc. at 1; PPL Generation, LLC and PPL Montana, LLC at 7–12; United States Department of Agriculture at 13; DOT at 1; Wisconsin Central System at 12.

10 *See, e.g.*, Ag Processing Inc. at 5–6; Ameren Services Company at 2–4; American Chemistry Council and American Plastics Council at 6-9; DOT at 5–6; Weyerhaeuser Company at 3–4.

fundamentally the manner in which the rail industry is regulated. Therefore, the Board and shippers should be leery of merger review proposals that would be seen by investors as resurrecting the heavy-handed regulation of the past. As DOT noted, the Board "must be certain in its evaluation that competitive enhancements do not result in long-run public disbenefits." DOT at 4–5.

Third, the many proposals that go well beyond the appropriate scope of merger rules — suggesting some form of open access for the entire industry, the reopening of past mergers, or the continued imposition of new conditions after a merger has been approved — also send the wrong signal to capital markets. Even though such proposals are beyond the scope of the rules proposed by the Board and beyond the proper scope of a rulemaking concerning merger policy, commenters attempted to justify them as a logical extension of the NPR.[11] This argument will raise fears in capital markets that the Board may be considering policy changes that would reverse the progress made by the rail industry in the past 20 years.

It is ironic that the attack on rail rates, however disguised by references to enhanced competition, is led by industrial giants whose revenues, profits, and ability to invest far exceed those of Class I railroads. Railroads are less profitable than many of the customers who are calling for reregulation, and the rail sector's financial performance is chronically inferior to that of other sectors. At a time when railroads are not earning the Board-defined

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[11] *See* American Forest & Paper Association at 5–6; California Public Utilities Commission at 3–5; City of Mankato, MN at 9; City of Owatonna, MN at 8; IMC Global Inc. at 3–4; National Grain and Feed Association at 7–8.

cost of capital, let alone "monopoly" profits, there is no reason to transfer wealth from the rail industry to some of its customers.

C. The Board Should Not Adopt Proposals That Would Result in Massive Reregulation of the Industry

Many commenters explicitly seek a fundamental restructuring of the manner in which the rail industry is regulated. Some of these commenters forthrightly admitted in their comments that they would pursue these requests even if the Board had not proposed a rulemaking to review its merger rules.[12] Other commenters tied their requests for heavy-handed regulation to the presumed harms threatened by future mergers, but then argued that any new rules applied to merging carriers must be extended, through one mechanism or another, to all other Class I carriers.[13] No party making these proposals would agree (and BNSF does not propose) that these mandated competitive enhancements replace the Board's traditional requirement that identified reductions in competition for specific shippers be remedied by appropriate conditions. Furthermore, the parties proposing these measures would object to such reregulation in their own industries, because it would not make economic sense to prevent efficiency-producing mergers that do not threaten unremedied competitive harms.

The Board should reject all proposals that it mandate open access, labeled as competitive enhancements, as the price of future mergers.[14] The adoption of such "open

[12] *See, e.g.*, Alliance for Rail Competition at 7.

[13] *See, e.g.*, Consumers United for Rail Equity at 3, 5, and 7; Montana Wheat & Barley Committee et al. at 5; NIT League at 3.

[14] The NPR properly rejected broad proposals for a general restructuring of the rail industry as beyond the appropriate scope of a review of the merger regulations. As BNSF and others pointed out in the ANPR phase, any such proposals would violate the specific

access" proposals would require the Board to regulate directly every aspect of the rail industry, even if ostensibly limited to individual merger proceedings. First, broad proposals that would result in some form of open access would multiply the service problems faced by the rail industry.[15] Second, any system of mandated partial or complete open access would require the Board to resolve disputes over access priorities.[16] Third, any system of mandated partial or complete open access would require the Board to adopt a full-time role

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statutory requirements applicable to mergers and, given the scope of the NPR, the requirements of the Administrative Procedure Act. Therefore, the Board should continue to reject all requests that it implement, in this proceeding, any general system of open access, competitive access, or similar proposals.

[15] The United States rail system is an extremely complicated private sector system, and open access models from other industries will not work for it. Unlike the natural gas and electric transmission grids, the rail industry does not carry a fungible good. While any electron can power a factory, the inputs to factories are not fungible. Unlike the telecommunications industry, which can take advantage of rapid technological development, the ability of railroads to expand capacity is limited. Unlike utility transmission systems or the telecommunications networks, railroads must "batch" their deliveries, assembling trains rather than carrying individual messages. The experience of rail regulation in other countries demonstrates that open access is not easily applied to the rail network and that facile comparisons to other industries are misplaced. *See, e.g.*, *Railways' Frightful State Is the Talk of Britain*, The New York Times, Sunday, December 10, 2000 at 3.

[16] For example, if multiple carriers are using the same facilities, the Board would have to decide how the carriers schedule their trains. The Board also would have to decide whether the carrier that owns the track must consult with other carriers before scheduling short maintenance projects or long-term upgrades. These coordination problems are extremely complex, and the Board could end up dictating the exact terms under which rail facilities across the United States are used.

of setting rates charged for access.[17] Finally, as some commenters admitted, open access imposed on a merger condition will tend to spread across the rail network.[18]

Therefore, the Board should continue to reject requests for the broad-based reregulation of the rail industry. Furthermore, the Board should recognize that mandated competitive enhancements imposed as merger conditions could inexorably lead to industry-wide reregulation.

D. The Board Should Continue to Review Proposed Mergers on a Case-by-Case Basis and Require Remedies for Specific Competitive Harms, Rather Than Generalized Competitive Enhancements

1. The Proposed Regulations Are Too Vague To Be Applied With Predictability, Certainty or Fairness

Many commenters, in addition to BNSF, objected to the NPR because the mandated competitive enhancement requirements are vague and lack standards. For example, some commenters were concerned that there are no proposed standards for determining how "much" competitive enhancement is required to offset the presumed harms that future mergers will produce.[19] However, the Board never will be able to designate, in advance,

[17] While some commenters suggested that this would be a simple process, involving only the setting of proportional rates, with some recognition of "local" costs, the process would be far more complicated. Because rates may vary based on the product, the term of any contract, the use of unit trains, and many other factors, the Board would be requested endlessly to develop rates that are applicable to any particular open access use of a carrier's facilities.

[18] Several commenters noted that it would be unfair to limit open access to future mergers, while others propose that non-merging carriers who take advantage of open access rights be required to offer such rights in return. Of course, still others argued that open access should be mandated for all. Under any scenario, the rail industry and capital markets would assume that a merger-related system of open access would quickly expand to cover the entire system, with the adverse consequences discussed in Part II.B above.

[19] *See, e.g.*, The Fertilizer Institute and The Canadian Fertilizer Institute at 4–8; NIT League at 10–14; and PPL Generation, LLC and PPL Montana, LLC at 18–20.

the required amount or "quantum" of competitive enhancements, because — unless the Board is planning to require system-wide open access — the proper quantum will depend upon the level of harm that must be offset in a particular merger.

Other commenters expressed concern about how the Board would decide which shippers or regions receive the benefits of any non-remedial competitive enhancements.[20] If the Board requires non-remedial competitive enhancements that, by definition, are unrelated to specific competitive or service harms, it will have to assume a nation-wide central planning role and decide which shippers, regional carriers or ports receive the benefits of the enhancements — and which will not receive such benefits.[21]

The comments also demonstrated that any requirement for generalized competitive enhancements will not eliminate the need for the Board to review specific conditions designed to maintain effective competition for adversely affected shippers. Each comment that addressed the issue was clear on this point – a shipper that would lose effective competition as a result of a proposed merger must be offered a remedy.[22] Yet, if the Board must identify and remedy each actual harm, there will be neither a need nor a justification for imposing broader conditions.

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[20] American Chemistry Council and American Plastics Council at 15; NIT League at 12, 15; The State of New York at 8–9.

[21] One commenter stated that any enhancements must be directed to industry or geographic areas that would be harmed by the merger. The Procter & Gamble Company at 3. This allocation issue will be solved if any conditions imposed by the Board are remedial.

[22] *See, e.g.*, American Chemistry Council and American Plastics Council at 12–13; State of New York at 8–9.

There is, of course, a simple answer — based on the existing Board practice — to these concerns: the Board should continue to review whether a particular merger will cause harm to specific shippers on a case-by-case basis, and it should then require specific conditions that offset identified harms. Absent such specific identification of harms and allocation of remedies, the Board will have no reasoned basis for allocation of the enhancements. Each merger proceeding will inevitably deteriorate into drawn-out arguments over who should — and should not — receive the boon of enhancements that are not remedial. This would not be sound regulatory policy.

2. <u>The Three Presumptions of the NPR Were Not Supported by the NPR Itself or the Comments</u>

The proposed requirement for mandatory non-remedial competitive enhancements is based on three presumptions set forth in the NPR. However, the NPR itself did not provide factual or legal support for those presumptions, nor did the November 17 comments filed in support of the presumptions.

First, the NPR presumed that future mergers will not create the same public benefits as past mergers. The NPR based this presumption on the view that mergers are no longer needed to address "excess capacity" or the rationalization of the rail industry. To the extent the comments contained any specific discussion, that discussion simply reiterated the NPR's position. However, BNSF's initial comments demonstrated that mergers will continue to provide public benefits because they will provide valuable tools for meeting the expressed desire of shippers for new and improved services, through increased investment and more efficient use of existing assets.[23]

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[23] Verified Statement of Robert D. Krebs, November 17, 2000, at 7.

Second, the NPR presumed that future mergers would result in unremedied competitive harms, although the NPR did not indicate why the Board could not identify, analyze and, when appropriate, remedy or condition the likely effects of any proposed merger on product, geographic or other competition. Many comments supported the Board's presumption, but without specific factual support for the position. The comments also did not indicate why any problems with product and geographic competition would not be resolved by the NPR's proposals to maintain open gateways and contract exception rights after a merger. The comments also did not indicate why further Board action would be required if any identified adverse competitive effects on specific shippers or shipper groups were mitigated through conditions.

Indeed, the Board itself has recently recognized that recent mergers, at least those in the West, have not undermined competition. In fact, the Board has concluded that "the record indicates vigorous competition and improved service in the West. Our conclusion that competition has not been undermined by this [UP/SP] and other recent mergers in the West is also confirmed by a comprehensive rate study recently released by STB staff. This study shows that rail rates in the West continued to decline rather sharply during the period from 1996 to 1999 when this merger was being implemented. In this 3-year period, western rail rates fell 9.0%, or 3.1% per year on an inflation-adjusted basis. Rail rates on coal movements in the West declined even faster, falling 14.2% in inflation-adjusted dollars, or 5.0% per year. Rate decreases of this magnitude could not have been realized if the UP/SP and BNSF mergers had substantially decreased rail competition in the industry."[24]

Therefore, BNSF agrees with the comments of DOT, which noted, "it is premature to conclude that [competitive harm] will occur in all cases." DOT at 4. Instead, the focus should be placed on an "attempt to match awards of additional competitive options to the specific shippers on whom the transaction otherwise would impose losses of such options." Id. Furthermore, BNSF believes that future mergers, like past mergers, will increase competitive pressures in both intramodal and intermodal markets.

Third, the NPR presumed that future Class I mergers would produce significant transitional service problems. Many of the comments reviewed the problems of the UP/SP merger and the Conrail/CSX/NS transaction. However, the comments generally did not recognize the unique circumstances of both transactions or consider whether the proposed revisions to the Board's regulations would adequately reduce the likelihood of future transitional service issues by requiring better advance planning and staged merger implementation.

Thus, the Board should remove the presumptions from any final rules and, instead, review each Class I merger based on its own merits. In future merger proceedings, applicants will address the public benefits their mergers are intended to produce. At that time, the Board can assess the claims and make a determination based on the record before it. Applicants also will address competitive issues, and the Board can be certain that

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[24] Union Pacific Corporation, et al. — Control and Merger — Southern Pacific Rail Corporation, et al., Finance Docket No. 32760 (Sub.-No. 21) Decision No. 16 (STB December 13, 2000) at 6, footnote omitted.

aggrieved shippers will request conditions to respond to any competitive problems (including effects on geographic and product competition) that the merger applicants have not proposed to remedy. Finally, merger applicants will address service issues, with greater specificity than in the past, and the Board will have the benefit of the scrutiny of interested parties. This case-by-case review will protect the interests of all parties.

3. Any Conditions Imposed on a Merger Should Be Remedial Only

In the past, the Board has reviewed the competitive and service effects of mergers and, to the extent the applicants have not proposed conditions that offset any such adverse effects, imposed remedial conditions. Retaining this tested approach to merger issues will respond to the legitimate issues raised by many commenters, because it will maintain the measured, case-by-case review that the Board has provided in the past.

As noted above, many commenters attacked the NPR because it is too vague on the amount or "quantum" and allocation of competitive enhancements offered in support of a proposed merger. However, if remedies are used to mitigate any specific harms for specific shippers, the quantum and allocation issues resolve themselves. Furthermore, if conditions are remedial, the parties will approach merger proceedings with firm guidelines in mind, and the Board will not be forced to determine which industry segments should receive special treatment or benefits — and which should not.

The use of remedial conditions allows fact-specific issues raised in the comments, such as the treatment of 3-to-2 shippers and the "one lump" theory, to be resolved on the basis of the facts of a particular merger. BNSF strongly believes that, in most cases, 3-to-2 shippers are not adversely affected by mergers and that the one lump theory is sound in theory and in practice. However, others take a different position. These issues, which the Board traditionally has reviewed on the basis of a factual record, should continue to be analyzed on the basis of specific proposals, rather than in the context of a generalized rulemaking.

The use of remedial conditions also would respond to two concerns raised by DOT. First, DOT stated that it is premature to conclude in all cases that a future merger will create competitive problems that cannot be directly remedied. Second, DOT stressed the "need to first attempt to match awards of additional competitive options to the specific shippers on whom the transaction otherwise would impose losses of such options." DOT at 4. Thus, remedial conditions should be the focus of any future merger proceedings.

4. The Proposals for Maintaining Existing Competitive Options Should Be Applied in Specific Cases

The NPR proposed that merger applications address how existing competitive options for shippers would be maintained after the merger. The NPR proposed that merger applications contain, among other things, proposals to maintain service options for 2-to-1 shippers, build-in/build-out and transload opportunities, major open gateways, and contract exception rights. There was widespread support for these proposals, although concerns were expressed about the exact implementation of the open gateway and contract exception provisions.

BNSF agrees with the NPR proposal to require that the merging carriers maintain the major open gateways, but others asked that the Board require that all gateways be maintained on an open basis.[25] The NPR proposal recognizes that the specifics of each

[25] *See, e.g.*, Ameren Services Company at 3; PPG Industries, Inc. at 2. One commenter even proposed that the Board create new gateways. North Dakota Public

gateway should be considered on the basis of a factual record, rather than decided on a generic basis. The commenters' alternative proposal, however, could result in the regulatory-imposed retention of gateways that, prior to a merger, carried little or no traffic. BNSF's formulation would not foreclose any arguments by any parties on the importance of a gateway, but it would avoid the creation of a rule that might be applied without analysis of specific facts or signal a return to policies which fostered creation or maintenance of inefficient, circuitous routes that existed in the pre-Staggers Act environment.[26] Furthermore, as a practical matter, if merging and non-merging carriers are required to keep all gateways open, the ability of carriers to improve service for rail shippers by selecting the most efficient routings and focusing volume onto through trains that pass through, rather than operate to, interchanges would be hampered. This could discourage infrastructure investment aimed at high-volume, scheduled interline operations, and could interfere with service improvements — both velocity and consistency — that shippers and shipper organizations have repeatedly stated they require to make greater use of rail transportation.

Any final rule also must recognize that an open gateway requirement will need the full operational cooperation of merging and non-merging carriers, including Class II and Class III carriers. The non-merging carriers also could close the gateways economically

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Service Commission et al. at 3.

[26] Thus, Bunge Corporation's concern that future Class I mergers would result in market foreclosures is without foundation. The Board would in any such future merger determine, based on the evidence submitted, whether a particular gateway needed to remain open to prevent such foreclosures.

or operationally. Therefore, any final rule must acknowledge the limits on the merged railroad's ability to maintain gateways.

Several parties argued that any open gateway policy must require that affected gateways be kept open on an operational and economic basis.[27] BNSF agrees, but again there is a difference of opinion on whether the rate issues should be decided by rule or in the context of a specific merger proceeding. There were several proposals to define the rate conditions applicable to open gateways. These included proportional rates (based on existing tariff rates or contract rates), freezes on existing rates, limits on the future adjustments to gateway rates, and similar detailed proposals.[28]

For example, the American Chemistry Council ("ACC") and the American Plastics Council ("APC") argued that the Board should require that rates to/from interchange points be established on a proportional basis, reflecting the distance of the entire haul.[29] However, many contract rates reflect a total economic package, one that may include minimum shipment commitments, service standards, a minimum term for service, and other conditions. Different commodities are subject to different rates, reflecting the requirements for handling the traffic, competitive issues, and other factors. It would be impossible for the Board to "unbundle" these contract terms and focus on the rate alone. Similarly, the ACC/APC proportional rate proposal included an adjustment for local terminal costs and

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27 *See, e.g.*, Ag Processing Inc. at 5–6; Edison Electric Institute at 9–10; The Fertilizer Institute and The Canadian Fertilizer Institute at 10–11; National Grain and Feed Association at 6–8.

28 *See, e.g.*, American Short Line and Regional Railroad Association at 3; Bunge Corporation at 5–6; NIT League at 20; PPG Industries, Inc. at 1–2.

29 American Chemistry Council and American Plastics Council at 6; *see also* Subscribing Coal Shippers at 17.

other variations. The Board could easily find itself adjudicating the rate applicable to every movement through a gateway. Even these examples leave aside the issues that would be raised by shipments of seasonal goods, where the Board should avoid any rate regulation.

Therefore, the final rules should contain a general standard calling for existing major gateways to be maintained as open on an operational and economic basis. However, the Board should not attempt to define by regulation how will it approach the many factual patterns that this general standard may raise in future merger proceedings.

The comments also included extended discussion of the proposed "contract exception" requirement for shippers affected by a merger. Some commenters apparently believe that the NPR's contract exception right would apply only to those shippers who hold a contract prior to the merger under review by the Board.[30] Others argued that the Board should eliminate the requirement that a shipper hold a contract before it can challenge the rate charged for the bottleneck segment.[31]

BNSF believes that some parties have misread the NPR, while others are seeking a fundamental change in the Board's policies. An example may help clarify the situation and the solution. Assume that two upstream carriers provide service to a shipper, interchanging traffic with a single downstream carrier that then merges with one of the upstream carriers. In that case, BNSF interprets the NPR to propose that the shipper could request a rate from the merged carrier for the downstream haul if it obtains a contract with the upstream, non-merging carrier. The shipper would have this right even though the

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30 *See, e.g.*, Certain Coal Shippers at 14–15; Martin Marietta Materials at 5–6.

31 *See, e.g.*, American Chemistry Council and American Plastics Council at 8–9; Enterprise Products Operating L.P. at 9; NIT League at 6–8; PPG Industries, Inc. at 2.

merged carrier could provide single-line service from the origin to the destination. Therefore, the merger of the upstream and downstream carrier would not eliminate the right of a shipper to seek relief under the Board's contract exception rules. BNSF would not object to this interpretation of the contract exception right. However, as noted by DOT, the Board cannot compel the non-merged carrier to enter into a contract with a shipper. DOT at 6.

There is widespread agreement on the need to maintain, after a merger, effective competitive options for those shippers who now have such options. However, as BNSF has demonstrated, specific mechanisms should be developed in individual cases because of the complexity and factual nature of the issues.

E. Future Merger Applications Should Address Service Assurances or Guarantees, But the Details Should Be Determined in Specific Cases

Many of the comments focused on the transitional service problems that might arise as a result of future mergers. Commenters asked that merger applicants provide service metrics, guarantees that there will be no post-merger deterioration in service, be held to binding arbitration at the election of the shipper or short line, be liable for compensatory damages, and be subject to other sanctions and remedies.

All parties agreed that a primary goal of merger policy should be the avoidance of future service problems, a position that BNSF enthusiastically endorses. BNSF further agrees that future merger applications should contain a detailed explanation of merger implementation plans and service recovery plans. However, the Board should not adopt the specific proposals urged by some commenters.

Many commenters stated that merged carriers should be responsible for any deterioration in service, apparently without regard to whether any service problems are merger-related. This is an unreasonable and unacceptable standard.

Post-merger service may not achieve pre-merger benchmarks for a variety of reasons that have nothing to do with the implementation of the merger. For example, the Department of Defense has sought assurances that defense needs will take priority during periods of national emergency, a position that BNSF assumes all commenters would support. It would, therefore, be unreasonable to hold a merged carrier responsible if defense needs preempted capacity or rolling stock.

As another example, the size of agricultural harvests and the demand for U.S. production — let alone the overall demand for rail service by all shippers in the United States — vary significantly from year to year. A railroad's ability to meet this demand and to maintain historic transit times for agriculture shippers, for example, will depend upon the ability of short line railroads and ports to process and return covered hoppers to the railroads, both merged and non-merged. The capacity of the rail industry can be strained by bumper crops or by an unexpected dearth of privately-owned cars. Other factors will affect demand for service and service performance, including the weather, natural disasters, scheduled and emergency maintenance, capital improvement programs, economic cycles, and overall demand in the entire economy.[32] Again, it would not be reasonable for carriers to be held liable for problems that are not related to a merger. Therefore, it is essential that any program of service assurances or guarantees distinguish carefully between merger and non-merger related problems.

Several comments attacked railroads' demurrage and car allocation practices.[33] Similarly, other comments objected to the increased emphasis of railroads on unit trains for grains and shipments of other commodities in larger volumes or longer blocks. However, much of the success in intermodal traffic which has produced dramatic growth has been based on the ability of the railroads to focus on procedures to attract and retain traffic on a trainload basis, versus a "single box" or shipment-specific basis. The use of these practices for other commodities increases the effectively available capacity of the rail network, and makes it more competitive for an increased amount of available traffic. Mandated changes to these practices would obviously affect the efficiency of rail operations.

It also is essential that any service assurance program not interfere with upgrades to the rail infrastructure. If railroads are to meet the competitive challenges posed by other

32 A railroad's performance may be affected by inputs it does not control. For example, the best computer system can be temporarily crippled by computer problems that are beyond the control of the railroad, such as new viruses, faulty software purchased from outside vendors, or defective patches provided by those vendors. A railroad's service also can be affected by shared use of facilities. Changes in the operations of commuter lines can affect rail performance, as can efforts to respond to community concerns or the requests of ports and regional carriers for service changes.

33 *See, e.g.*, American Short Line and Regional Railroad Association at 3; Finger Lakes Railway Corp. at 10; Texas Crushed Stone Company and Georgetown Railroad Company at 10.

modes of transportation and to provide the improved services shippers want, they will need continually to add or improve infrastructure. This can include upgrading rails, inserting ties, surfacing and leveling track, installing improved signal systems, expanding yard capacity, building new mainlines and sidings, and other actions. Any one of these actions may require short-term disruptions in service in order to achieve long-term benefits. It would be counterproductive to discourage railroads from taking these actions.

Finally, many commenters requested that the Board require railroads to provide shippers (including regional carriers) with compensatory damages for any post-merger service problems. Some parties requested the right for damages, apparently even if the railroad meets the service standards contained in their contracts with the railroads.

BNSF believes that the remedies for service problems and the procedures for resolving disputes should be determined in each merger proceeding. Generic rules would be impossible to develop, particularly given the different levels of service and different rate structures contained in the many contracts in the industry. Thus, the final rules should adopt the formulation of DOT, which defines compensation as a form of access to alternate transportation, rate discounts, or recovery of losses.[34] However, specific proposals should be developed to address identified needs in individual merger proceedings.

BNSF also believes that the Board should not decide, as a rule of universal applicability, that so-called compensatory damages are appropriate or necessary. The liability of many of the railroads' key vendors is limited to exclude consequential or

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34 DOT at 9. DOT also proposed that the details of any service guarantees "be negotiated between applicants and shippers, connecting small railroads, as well as Amtrak" and commuter railroads. *Id.*

compensatory damages and to cap damages at the amounts paid by BNSF under the contract.[35] Thus, railroads will be subject to unreasonable financial risk, and they will not be able to attract capital, if they are automatically subject to types of damages that are not customary in the economy.

BNSF is not arguing that no level of damages is ever appropriate in some cases. However, the standards of performance, the avenues for relief, and the methods for resolving disputes must be considered in the context of the overall commercial relationship between the parties. Furthermore, in reviewing this issue, the final rules should reflect the alternative avenues for relief the Board has already created, including the Ex Parte No. 628 rules the Board adopted after the UP/SP service problems and the remedies that can be obtained through the regular oversight process. Shippers also may turn to the courts, as several did after the UP/SP and Conrail/CSX/NS difficulties.

Therefore, the Board should require that merger applicants propose a service assurance plan, including remedies for shippers. The Board should review the adequacy of that plan as part of its overall evaluation of whether a specific merger is in the public interest.

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35 While BNSF has not undertaken a comprehensive review, it understands that the tariffs of most electric utilities from which it purchases service contain provisions that exclude any damages in the absence of gross negligence or intentional misconduct. Many of the tariffs even limit any relief from reservation charges in the event the utility is unable to provide service.

F. Oversight Should Be Limited to Issues Arising Out of the Specific Merger

The comments expressed a broad consensus that the Board must be vigilant, during a five-year oversight period, in its review of any service problems that arise from a merger and its examination of any failure of the competitive conditions imposed on the merger. BNSF agrees with this position and believes that such an approach should alleviate shipper concerns about transitional service problems and reductions in effective competition.

However, some commenters sought to expand the Board's oversight responsibilities to other areas. For example, some parties suggested that the Board could use its oversight authority over existing mergers to impose broad open access conditions retroactively, even if such conditions are unrelated to competitive issues directly raised by such mergers.[36] Any such action by the Board would be both contrary to the statute and destructive of the industry's ability to attract and retain capital and would negatively affect the industry's ability to grow and attract profitable business.

Other commenters stated that a merged railroad should be subject to a penalty if predicted merger benefits are not realized on the predicted schedule.[37] In its initial comments, BNSF discussed how such a condition could prevent railroads from responding to changed circumstances. For example, such a condition would encourage a merged railroad to reduce its workforce to meet labor forecasts, even if that could adversely affect service. This condition would encourage the flight of capital from the industry, because the rail industry would be subject to sanctions that no other industry — including the industries of many of the commenters who both proposed such sanctions and themselves are the

36 *E.g.*, City of Mankato, MN at 9.

37 *See, e.g.*, State of New York at 19.

products of mergers — would accept or could bear. There can be no guarantees in this dynamic economy.

Other parties suggested that a merged railroad should be subject to the imposition of new retroactive conditions in response to a subsequent merger or the emergence of unforeseen competitive harms. Because conditions should be remedial, any competitive problems caused by a subsequent merger should be resolved by remedies imposed on that subsequent merger. With respect to unforeseen competitive harms, the Board already has the ability to take further action if a competitive condition imposed on a merger fails to achieve its results, and shippers and competing railroads have been quite willing to seek post-merger relief from the Board. The broader formulation sought by some parties would, however, remove any finality to Board action and create the risk that the Board would impose far-reaching conditions that the merger applicants would not have accepted as the price of consummating their merger. The Board itself has recognized that merger applicants must be given a clear choice, based on the conditions present at the time, when deciding whether to proceed with a merger, and the Board should adhere to this policy.

A merged railroad will have strong economic incentive to achieve any growth in business and revenue, savings or improved efficiencies described in the merger application. However, circumstances change. Therefore, Board oversight should be limited to the two issues that most directly affect shippers – the quality of service and the efficacy of any conditions imposed to offset competitive harms that otherwise would arise from the merger.

G. Other Issues Raised by the Comments

1. Class II and III Railroads

Many short lines, with the support of some shippers and governmental entities, repeated their request that the Board impose the short line "Bill of Rights," either as a condition on any future merger or on an industry-wide basis. The broad themes of the "Bill of Rights" are not merger-related and, therefore, are beyond the scope of this proceeding. With respect to merger-related issues, BNSF agrees that short lines and regional carriers are entitled to service assurances against service-related and competitive harms arising from a proposed merger.

While BNSF believes that much of the "Bill of Rights" is not merger-related and, in any event, disagrees with certain aspects of that proposal, BNSF wishes to emphasize the importance of short lines and regional carriers in the national transportation system and their vital importance to the success of Class I railroads.

2. Ports

Several ports expressed concerns about the effect of future mergers on ports. Ports are important partners of BNSF and other railroads, and the success of each segment depends upon cooperation from the other. BNSF agrees that merger applications should address the service implications for ports. However, merger applicants should not be required to guarantee that there will be no adverse effects on ports, as traffic patterns will change over time based on the services offered by ports and railroads, export and import patterns, and the preferences of shippers.

3. Commuter Lines

BNSF agrees that merger applications must address the effects on existing commuter services, ensuring that the interests of freight carriers and commuter lines are balanced. However, efforts to work with commuter lines may affect other parties, because competing requests for one type of service may affect the merged railroad's ability to provide other types of service.

4. Acquisition Premium

Several shippers requested that the Board prohibit a merged carrier from including any "acquisition premium" in the derivation of rates or the determination of a carrier's revenue adequacy. The Board has resolved these issues in past proceedings, and there is no basis for reopening the issue.

However, BNSF agrees that the Board should review in merger proceedings whether the merged carrier would have the financial ability, including the ability to service merger-related debt, to carry out its service integration and infrastructure plans. This is a necessary corollary of BNSF's position that the Board must place increased emphasis on service issues.

5. Alliances and Joint Ventures

In its comments, BNSF argued that the Board should not attempt to guess whether projected merger benefits could be achieved through alliances or joint ventures. BNSF stressed that carriers have strong incentives to achieve benefits and synergies when that is practicable through alliances, thereby avoiding the costs and risks of a merger proceeding before the Board. BNSF also demonstrated that a merged railroad will have greater ability to achieve efficient operations and to optimize the use of resources than would an alliance.

In their comments, some parties approached the alliance/joint venture issue from an entirely different perspective, arguing that the Board should review all alliances and joint ventures.[38] These requests should be rejected. First, the Board lacks authority to review or condition alliances that do not involve "control." Second, while some parties raised antitrust issues concerning alliances, nothing exempts such alliances from the scope of the antitrust laws.

38 *See, e.g.*, American Chemistry Council and American Plastics Council at 11; The Dow Chemical Company at 20–22; NIT League at 27–30; The Ohio Rail Development Commission at 16.

III. CONCLUSION

The Board's review of its merger policy comes at a critical time for the rail industry. The industry has made significant strides in improving service, responding to intermodal competition, and restoring its financial health in the last 20 years. However, the rail industry needs to make additional progress, and the necessary steps to meet the expectations and needs of shippers and other stakeholders will require that railroads attract and retain capital.

Railroads have no ability to "draft" capital; they must compete for capital in the market. The Board's final merger rules will determine, in large part, how capital markets will view the industry. The Board must avoid any actions that would cause capital to flee the industry, either by imposing unreasonable restrictions on future mergers or by threatening a return to the interventionist regulatory policies that preceded the successes of the 4R and Staggers Acts.

Therefore, any final rules should contain the following elements:

1. The Board should complete its review of any merger application within one year of the pre-filing notice, and the Board should reject those proposals that would extend the review period, limit the ability of merger applicants promptly to file their application, or constrain the ability of the merged carrier fully to implement the merger.

2. The Board should not adopt the presumptions that future mergers will not produce public benefits, that mergers will produce unremedied competitive harms, and that mergers will cause transitional service problems. The Board should not require that merger applicants propose "competitive enhancements" that are not remedial in nature, and it

should reject all proposals that call for significant reregulation of the rail industry, including open access, competitive access and rate proposals. The Board also should not adopt detailed regulatory prescriptions for all the issues raised in merger cases. Instead, these issues should be addressed based on the facts of any specific merger proposal, using the Board's tested case-by-case approach.

3. The final rules should require merging carriers to propose plans for maintaining effective competition for shippers. Such plans should include proposals to maintain existing major gateways as open on an operational and economic basis, and to preserve (a) service options for 2-to-1 shippers, (b) build-in/build-out and transload opportunities of shippers, and (c) contract exception rights for shippers even when the merged carrier can provide single-line service to a shipper. The final rules should require merger applicants to address whether any shipper would lose effective competition as a result of the merger and, if so, propose conditions to maintain that effective competition.

4. The rules should require the full analysis and, as appropriate, remedy of competitive issues raised by a specific merger, but this factual analysis must be on a case-by-case basis.

5. The final rules should require merger applicants to provide detailed service assurance plans. The adequacy of the plans and any proposals to provide shippers with remedies in the event that service deteriorates for merger-related reasons should be part of the Board's public interest determination, but the Board should not dictate the nature of any remedies in its rules.

6. The rules should state expressly that post-merger oversight review will be limited to merger-related service problems and the efficacy of any remedial competitive conditions adopted as part of the merger.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that copies of The Burlington Northern and Santa Fe Railway Company's Comments are being served on all parties of record this 18th day of December, 2000.

David I. Bloom